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United States

In the Supreme Court of the United States

OCTOBER TERM, 1976

BOISE CASCADE CORPORATION, AND SUBSIDIARY
COMPANIES, PETITIONERS

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF CLAIMS*

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Department of Justice,
Washington, D.C. 20530.

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No. 75-1853

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The question presented in this federal income tax case is whether income realized by petitioners from the sale or redemption of certain non-interest-bearing notes, which they had acquired at a discount, should be taxed as ordinary income or as short-term capital gain.¹

The pertinent facts are as follows: During the period 1955 through 1961, petitioners' corporate predecessors acquired certain non-interest-bearing short-term notes at less than face value and sold or redeemed the notes

¹The identical question is presented in *General Foods Corp. v. United States*, 530 F. 2d 923 (Ct. Cl.), petition for a writ of certiorari pending, No. 75-1871. We are serving a copy of this memorandum in opposition upon counsel for the petitioner in that case.

after holding them for not more than six months. Upon the disposition of the notes, petitioners realized income attributable to original issue discount, which is the excess of the redemption price at maturity over the issue price. This income was entirely generated as a result of the passage of time and not by fluctuations in market value (Pet. App. A-2 to A-3).

Petitioners reported this income from original issue discount as short-term capital gain. On audit, the Commissioner of Internal Revenue determined that the original issue discount should be treated as ordinary interest income rather than short-term capital gain so that petitioners could not offset such income against net capital losses. In this refund suit, the Court of Claims upheld the Commissioner's determination on the authority of its decision of the same day in *General Foods Corp. v. United States*, 530 F. 2d 923 (Pet. App. A-3 to A-4; Pet. App. B-1 to B-3).

Section 1232 of the Internal Revenue Code of 1954, as amended (26 U.S.C.), generally provides that amounts received from the retirement of certain corporate indebtednesses will be treated as amounts received in exchange for the indebtedness. Thus, if the transaction meets certain prescribed criteria, the gain will be taxable at preferential capital gains rates. In this respect, Section 1232 carries forward the rule of Section 117(f) of the 1939 Code (26 U.S.C., 1952 ed.).

However, as originally enacted in 1954, Section 1232 contained the added proviso that the gain realized from the sale or retirement of such indebtedness issued after December 31, 1954, and held for more than six months, would be taxable at ordinary income rates when such gain was attributable to original issue discount. In its original form, Section 1232 did not expressly prescribe the tax treatment of gain attributable to original issue

discount on indebtedness held for six months or less. In 1969, Section 1232 was amended to provide that original issue discount with respect to indebtedness issued after May 27, 1969, would be taxable as ordinary income on a ratable basis as earned, without regard to whether the indebtedness had been held for more or less than six months.

Petitioners argue (Pet. 7-8) that the decision below conflicts with certain language in the House and Senate Committee reports with respect to the original enactment of Section 1232 and the Senate Committee report concerning the 1969 amendment to that section. Specifically, petitioners refer to the statements in the 1954 Committee reports (H.R. Rep. No. 1337, 83d Cong., 2d Sess. A275 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 433 (1954)) that amounts received on the redemption of post-1954 bonds and evidences of indebtedness (except to the extent that ordinary income treatment is provided for original issue discount on such bonds and evidences of indebtedness held more than six months) will receive capital gains treatment "if they [the bonds or other evidences of indebtedness] are otherwise capital assets" (Pet. App. A-13). The Senate Finance Committee report on the 1969 amendments to Section 1232 also states (S. Rep. No. 91-552, 91st Cong., 1st Sess. 148 (1969)) that the gain on the sale or exchange of a pre-1969 evidence of indebtedness held for not more than six months would qualify as short-term capital gain if the evidence of indebtedness is "a capital asset in the hands of the taxpayer."

Contrary to petitioners' argument, the statements in these committee reports do not support their claim to capital gains treatment on their original issue discount income. As the committee reports demonstrate, Congress expressed the view that gain from the sale of evidences

of indebtedness held for not more than six months qualifies for short-term capital gains treatment only if the indebtedness is a capital asset. The committee reports do not address the question of the tax consequences of income from original issue discount, which is at issue in this case. While the proper tax treatment of original issue discount was open to some doubt prior to the enactment of the 1954 Code (see *Commissioner v. Caulkins*, 144 F. 2d 482 (C.A. 6)), the question was authoritatively resolved by this Court in *United States v. Midland-Ross Corp.*, 381 U.S. 54, which held that gain attributable to original issue discount is in the nature of interest income and is taxable at ordinary income rates.

Although the taxable years at issue in *Midland-Ross* were governed by the 1939 Code, the rationale of that decision applies with equal force to the 1954 Code years involved in this case.² Thus, to the extent that amounts received by a taxpayer on the sale or retirement of bonds or other evidences of indebtedness are attributable to original issue discount, those amounts are not entitled to capital gains treatment because their source is not a capital asset.

²Section 1232, as enacted in 1954, does not affect the treatment of original issue discount on obligations held for not more than six months, as in this case. Thus, the Court's statement in *Commissioner v. National Alfalfa Dehydrating and Milling Co.*, 417 U.S. 134, 145 n. 9, concerning the impact of Section 1232, has no bearing on this case. The Court's reference to the "different approach" of Section 1232 refers to the statutory resolution of the tax treatment of original issue discount on obligations held for more than six months. But the tax treatment of original issue discount on obligations held for not more than six months was not covered by Section 1232. It therefore remained subject to the general ordinary income rule established by *Midland-Ross*.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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